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SUBJECT: CHINA INTRODUCES NEW MEASURES TO BOOST CONFIDENCE IN  
INSURANCE INDUSTRY

REF: (A) 08 Beijing 01569 (B) 08 Beijing 07535

11. (SBU) SUMMARY. On February 28 China's National People's Congress (NPC) adopted an amended Insurance Law as part of the government's efforts to boost credibility and consumer confidence in the industry. This long-awaited amendment will take effect on October 1. The new law includes measures to regulate insurance company transactions and improve governance practices through tightened government control and oversight, as well as protect the rights of the insured. A prominent industry expert tells emboffs that the amendment and additional recent regulations are a response to a high level of consumer complaints about the industry. Overall, foreign industry contacts welcomed the amendment as a step in the right direction towards improved transparency and consumer protection, and are pleased that restrictions on the reinsurance market have been relaxed. However, contacts are disappointed that their suggested changes to the branch licensing process were ignored, and that barriers to entering other markets, such as auto insurance, were not lifted (Ref A). End Summary.

12. (U) At a February 28 session of the Standing Committee of the NPC, Chairman Wu Bangguo and committee Vice Chairpersons approved an amendment to the Insurance Law designed to encourage both fiscal and managerial responsibility in China's insurance industry. The amended law includes the following key measures: 1) gives the China Insurance Regulatory Commission(CIRC)the power to halt transactions by insurance companies and their subsidiaries that are deemed too risky; 2) authorizes CIRC to restrict salaries of board members and senior administrators of insurance companies with inadequate solvency; 3) expands the investment choices for insurance companies; and 4) gives both foreign and domestic companies more flexibility in the reinsurance market.

PRC Stressing Quality, Not Quantity

13. (SBU) An influential insurance expert at Beijing's China University of Political Science and Law told emboffs that the amendment is focused on creating a quality insurance market, not necessarily expanding the market. According to foreign industry contacts, the amendment reflects a good faith effort by the government to address long-standing customer dissatisfaction with the industry. The 2008 Sichuan earthquake highlighted severe problems with life and personal property insurance sales. According to Chinese media sources, customers were misled by sales representatives at the point-of-sale, only to be left empty-handed after the disaster struck. Industry sources acknowledge consumers' negative perception of the industry, and cite lack of professional training, transparency, product choice, and consumer education as the major contributing factors (Ref B).

Amendment Addresses Global Financial Crisis Worries

14. (U) At the annual National Insurance Working Conference on December 27, CIRC Chairman Wu Dingfu expressed anxiety over industry prospects for 2009-2010, despite a 42% growth in premium income in 12008. He listed greater risk for overseas investment, and lower than

expected return for the investment products as some of the challenges the industry faces. To address these concerns, the amended Insurance Law allows companies to invest in: infrastructure construction projects; other property assets such as real estate; and marketable securities such as bonds, stocks, and funds. (Note: The original Insurance Law allowed only investment in government and financial bonds. End note.) Both foreign and domestic industry sources welcomed the opening of investment channels.

#### Onerous Reinsurance Articles Deleted

15. (SBU) For foreign insurance companies, the biggest direct change may concern reinsurance. Foreign companies welcomed the removal of two provisions that had restricted domestic insurance companies from entering into outbound reinsurance contracts with foreign-invested companies. The amended Law's Article 105 provides that domestic insurance companies may conduct outbound reinsurance matters solely on "prudential grounds." (Comment: Interestingly, this change was not highlighted by the National People's Congress in its explanation of the amendment of the Law. Foreign companies were pleased to see the new provision, but think the gains here could just be a by-product of the Chinese government trying to support domestic companies' interests. It is also possible the Chinese government did not want to highlight this perceived opening to foreign-invested companies. End comment.)

#### Regulations Bring New Training Woes

16. (SBU) In January 2009, CIRC imposed new regulations as part of a bigger plan to "clean up" the industry and restore consumer confidence, according to an industry expert. Companies are now

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regulated by the CIRC Supervision Scheme, which aims to tighten the management of insurers, particularly those with poor governance structures, and ranks insurance companies in descending order, "A," "B," "C," or "D." The companies rated "D" have serious problems in payment, corporate governance, capital management, or market behavior. This ranking system applies to all insurance companies, foreign and domestic alike, and comes with new training requirements for upper level management personnel. Foreign industry contacts told emboffs that they need clarification on the new management training curriculum and information on the level of management CIRC is targeting for training on company governance issues. U.S. insurance companies already complain of wasting management time in Chinese-language mandatory training imposed by CIRC.

17. (SBU) In addition to the Supervision Scheme, CIRC recently announced it will ban sales of investment-linked life insurance products at bank counters designed for depositors. As of March 15, banks will be allowed to sell investment-linked insurance products only through their wealth-management counters, and representatives selling these products are required to have at least one-year of experience selling life insurance and 40 hours of special training. These new regulations are designed to make it difficult for unqualified sales representatives to sell risky products to uninformed consumers. A foreign industry contact commented that the regulations were no surprise, as CIRC announced them well ahead of time, and that in the long-run they are good for the industry as a whole. He did add, though, that the announcement of new training is cause for concern and his company will be taking the issue up with CIRC.

18. (SBU) In addition, foreign industry sources tell emboffs that they fear this new environment could bring more training requirements for managers and CEOs. They hope CIRC will inform them of any new training requirements in the works.

#### New Priorities Exacerbate Long-standing Issues

19. (SBU) The current CIRC-imposed moratorium on opening sales offices throughout China is unlikely to be lifted soon. A foreign industry contact suspects that the suspension of sales office approval was targeted at Chinese companies that mislead customers at the point-of-sale. Currently, foreign companies face significant

barriers to opening large regional branch offices in China (which requires central government approval), and in the past have relied on opening small local sales offices (locally permitted) to enter Chinese markets. Chinese companies currently receive branch licenses at a much faster rate than foreign-invested firms, making the moratorium on the opening of smaller sales offices less of a burden to them, as the Chinese firms can rely on their ever-multiplying large branch offices to sell products. Our contact lamented that U.S. companies always share the punishment equally, but are not on equal footing with Chinese companies when it comes to industry advancements.

#### No Revisions Made to Article on Branch Licensing

¶10. (SBU) With regard to branch licensing, Article 81 of the previous version of the Insurance Law states that the Supervision and Administration Department of the State Council will decide whether to approve or disapprove an application for the establishment of branches or sub-branches. Foreign industry contacts reported that they submitted a request to the State Council to allow re-submission of applications initially denied. Our contacts were disappointed to learn that the Amended Insurance Law did not include this suggested revision to Article 81.  
CIRC's Role in Industry Feared Too Broad

¶11. (SBU) Sources from foreign-invested insurance companies are uneasy about CIRC's supervisory role over the Insurance Association of China (IAC). Many sources shared their fears that CIRC wears too many hats, as it makes all the laws and regulations in addition to overseeing the industry association. Representatives of foreign-invested insurance firms were pleased to see that the new law does not include the old law's Article 158, which stated that the Insurance Association could impose disciplinary punishment upon members that violate the IAC's bylaws or industry self-disciplinary rules.

¶12. (SBU) According to an industry expert, the new Supervision Scheme allows CIRC to take strict measures and possibly "take over" companies that receive a "D" ranking. Article 139 of the new Insurance Law clarifies this by stating that CIRC will be given strong authority to supervise insurance companies with inadequate solvency capacity, including orders to increase capital and increase the cession of reinsurance, restrict the scope of business, limit the distribution of dividends, restrict the purchase of fixed assets and other operations, restrict the form and proportion of other uses of funds, restrict stock offerings, prohibit the transfer of bad

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assets and the transfer of business lines, limit the compensation of directors, supervisors and senior officers, restrict advertising, and suspend the acceptance of new business.

#### Comment

¶13. (SBU) Many of these changes do appear intended to improve corporate governance and protect consumer interests, which will generally benefit the market's development. However, the net costs and benefits to U.S. companies from the changes will depend on CIRC's implementation of new administrative rules. End Comment.

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